UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
STONEBRIDGE TECHNOLOGIES, INC.	§	**Case No. 01-37474-HDH-11**
	§	
Debtor	§	

DENNIS FAULKNER, in his capacity as Trustee of the SBTI Liquidating Trust,	§	
	§	
Plaintiff,	§	
	§	
VS.	§	**Adversary No. 02-3187**
	§	
EOP-COLONNADE OF DALLAS, LP,	§	
	§	
Defendant.	§	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

I. Findings of Fact

1. On September 21, 2000, Stonebridge Technologies, Inc. ("Stonebridge") and EOP-Colonnade of Dallas, LP ("EOP") entered into a lease wherein Stonebridge agreed to lease office space in the Colonnade Tower III office building located on Dallas Parkway (the "Lease"). (Ex. 1.)

2. Stonebridge was required to provide a security deposit to EOP. The security deposit was defined in the Lease as follows:

> "Security Deposit": $105,298.85 in cash and a letter of credit in the amount of $1,430,065.74 which sum shall be reduced pursuant to the terms and conditions set forth in Section VI.B. of this Lease and eventually eliminated pursuant to the terms and conditions set forth in Section VI.C. of this Lease.

(Ex. 1 at 1.)

3. On or about September 21, 2000, Stonebridge provided EOP the Security Deposit under the Lease. (Joint Pre-Trial Order at 7, Stip. 4.)

4. The Letter of Credit provided to EOP under the Lease was an Irrevocable Stand-by Letter of Credit issued by the Bank of Oklahoma (the "Bank") in favor of EOP (the "Letter of Credit"). (Ex. 2.)

5. On September 15, 2000, Stonebridge executed a note payable to the Bank, secured in part by a $1,250,000.00 certificate of deposit (the "CD"), to secure the Bank against a draw on the Letter of Credit. (Exs. 12-13; Joint Pre-Trial Order at 7, Stip. 5.)

6. Pursuant to the terms of the Letter of Credit, $1,430,065.74 was available for payment at sight by a draft drawn by EOP on the Bank when accompanied by the following documents:

A. The original of the Irrevocable Stand-by Letter of Credit;

B. The beneficiary's (EOP) dated statement purportedly signed by one of its officers reading:

> "This draw in the amount of $_____ U.S. Dollars ($_____) under your Irrevocable Stand-by Letter of Credit No. BOK00SDF07102 represents funds due and owing to us as a result of the applicant's failure to comply with one or more terms of that certain Lease by and between EOP-Colonnade of Dallas Limited Partnership, a Delaware limited partnership, as Landlord, and Stonebridge Technologies, an _____, as Tenant beyond notice and cure periods as set forth in Section XIX of the Lease."

(Ex. 2; Joint Pre-Trial Order at 7-8, Stip. 6.)

7. On September 6, 2001, Stonebridge filed a Petition for Relief under Chapter 11 of the United States Bankruptcy Code and eventually confirmed a plan of liquidation.

8. At the time of the filing of the bankruptcy case, Stonebridge owed EOP rent and other charges, including tenant improvement overages, electric bills and invoices from work orders

performed by EOP, totaling $71,895.61, plus rent for September 2001 totaling $105,298.85. (Joint Pre-Trial Order at 8, Stip. 8).

9. Following the bankruptcy filing, in September 2001, Stonebridge, through Mr. Patrick Gibbons, CEO and "responsible person," negotiated with EOP to reduce the amount of leased space and to reduce the lease obligations, including post-petition expenses. (Joint Pre-Trial Order at 8, Stip. 10.)

10. After the bankruptcy filing, Stonebridge paid EOP a total of $50,000 which was applied to the September, 2001, post-petition rent due under the Lease. (Joint Pre-Trial Order at 9, Stip. 11.)

11. On September 10, 2001, Stonebridge filed a Motion to Sell Assets ("Motion to Sell") to Stonebridge Acquisition, Inc. ("SAI"), a corporation that was formed by insiders of Stonebridge to acquire the assets of Debtor. (Joint Pre-Trial Order at 9, Stip. 12.)

12. On October 15, 2001, EOP filed a Motion for Payment of Rent Pursuant to 11 U.S.C. § 365(d)(3), and asked the court to order Stonebridge to pay the unpaid balance of the September 2001 rent of $37,749.50, plus late fees, and October rent of $105,888.40, plus late fees. A hearing on this motion was set for October 23, 2001, the same day as the hearing on Debtor's Motion to Sell. (Joint Pre-Trial Order at 9, Stip. 13.)

13. On October 23, 2001, EOP and Stonebridge announced in open court an agreement that the Lease would be rejected effective no earlier than October 1, 2001 and no later than October 23, 2001, depending on the parties' success in finalizing a new short-term lease. The short-term lease was to be assumed by Stonebridge and assigned to SAI. (Joint Pre-Trial Order at 9, Stip. 14.) The Court did not enter an order rejecting the Lease on October 23, 2001. Instead, a hearing was set

for November 8, 2001, in which the Court was to determine whether to reject the Lease and if so, the effective date of the lease rejection if no new short-term lease had been consummated.

14. As part of the agreement reached in accordance with the rejection of the Lease, EOP was allowed an administrative rent claim in the amount of $42,137.50 and the parties agreed that pre-petition rent due for September was $17,549.81. (Joint Pre-Trial Order at 9, Stip. 15.)

15. On October 23, 2001, the court also approved Debtor's Motion to Sell. (Joint Pre-Trial Order at 9, Stip. 16.)

16. One day earlier, on October 22, 2001, EOP initiated a draw request via overnight delivery to the Bank under the Letter of Credit in the amount of $1,430,065.74. (Joint Pre-Trial Order at 9, Stip. 17.) However, no agreement existed between the parties on October 22, 2001 that the Lease would be rejected as of October 1, 2001.

17. In its draw request to the Bank, EOP represented the following:

> THIS DRAW REQUEST IN THE AMOUNT OF ONE MILLION FOUR HUNDRED THIRTY THOUSAND SIXTY-FIVE AND 74/100 U.S. DOLLARS (1,430,065.74) UNDER YOUR IRREVOCABLE STANDBY LETTER OF CREDIT NO. BOK00SDF07102 REPRESENTS FUNDS DUE AND OWING TO US AS A RESULT OF THE APPLICANT'S FAILURE TO COMPLY WITH ONE OR MORE OF THE TERMS OF THAT CERTAIN LEASE BY AND BETWEEN EOP-COLONNADE OF DALLAS LIMITED PARTNERSHIP, A DELAWARE LIMITED PARTNERSHIP, AS LANDLORD, AND STONEBRIDGE TECHNOLOGIES, A DELAWARE CORPORATION, AS TENANT BEYOND NOTICE AND CURE PERIODS AS SET FORTH IN SECTION XIX OF THE LEASE.

18. The draw request was received by the Bank on October 23, 2001. The next day, on October 24, 2001, the Bank notified EOP that the documents submitted by EOP did not meet the strict requirements of the Letter of Credit, and refused to honor it. Specifically, the draw request was not made on EOP's letterhead or signed by an officer of EOP. Thereafter, on October 24th, EOP

delivered another draw request to the Bank, still dated October 22, 2001, that corrected the deficiencies. This request was received by the Bank on October 25, 2001 and the Bank considered the draw request effective as of that date. (Joint Pre-Trial Order at 9-10, Stip. 18.)

19. EOP's representation to the Bank contained in the Letter of Credit draw request was made with reckless disregard for its truth or falsity because, at the time it was made, the sum of $1,430,065.74 was not due and owing to EOP under the Lease and EOP knew or should have known that it was not due and owing.

20. Alternatively, EOP failed to exercise reasonable care or competence in determining the truth or falsity of the representation made in the Letter of Credit draw request.

21. EOP intended for the Bank to rely on the representation made to the Bank in its draw request regarding the amount that was due and owing under the Lease.

22. On October 30, 2001, the Bank honored EOP's draw request, issued an expense check in the amount of $1,430,065.74 and delivered it to EOP. (Joint Pre-Trial Order at 10, Stip. 19.) The Bank justifiably relied on the representation made to the Bank in EOP's draw request when it honored the draw request.

23. On November 7, 2001 a new short-term lease was executed by EOP and Stonebridge. (Joint Pre-Trial Order at 10, Stip. 20.)

24. On November 8, 2001, the Court entered an Agreed Order Approving Rejection of Lease and Allowing Claim of EOP-Colonnade of Dallas Limited Partnership for Rent Pursuant to 11 U.S.C. § 365(d)(3) (the "Agreed Order"). (Joint Pre-Trial Order at 10, Stip. 21.) Pursuant to the terms of the Agreed Order, the Lease was deemed rejected as of October 1, 2001.

25. On December 12, 2001, the Bank sought relief from the automatic stay to permit it

to apply the CD to Stonebridge's note obligation arising from the draw on the Letter of Credit. Stonebridge and the Bank agreed that the automatic stay should be lifted to permit the Bank to apply the proceeds of the CD against the Stonebridge's promissory note obligation to the Bank. In addition, pursuant to a Compromise and Settlement Agreement approved by this Court on this April 5, 2002, the Bank assigned to Stonebridge its claims and causes of action against EOP arising from EOP's draw request, and released its claims against Stonebridge and Stonebridge's bankruptcy estate. (Joint Pre-Trial Order at 10, Stip. 22.)

26. As a result of EOP's misrepresentation to the Bank, the Bank was damaged. The Bank sustained damages in the amount of $180,065.74, which is the difference between the amount paid to EOP under the Letter of Credit and the amount received by the Bank from the CD.

27. As a result of EOP's breach of the Lease, Stonebridge sustained damages in the amount of $2,267.23 plus interest. These damages are measured by the difference between 1) the amount of the CD ($1,250,000) and 2) EOP's damages for lease rejection pursuant to 11 U.S.C. § 502(b)(6) ($1,353,031.62) less the cash security deposit ($105,298.85). This amount represents the sum total of what Stonebridge was wrongfully out-of-pocket, with the Bank being wrongfully out-of-pocket $180,065.74.

28. Stonebridge also would have been entitled to recover interest on the $180,065.74 it paid to Bank; however, no proof was offered at trial that Stonebridge paid any interest to Bank and the Settlement and Compromise does not, on its face, provide for such payment. Therefore, Bank's recovery of pre-judgment interest, if allowed by law, on its damages serves to make the parties whole.

29. Any finding of fact may also be deemed a conclusion of law.

II. Conclusions of Law

1. Jurisdiction is proper in this Court pursuant to 28 U.S.C. §§ 1334 and 157.

2. Venue is proper in this district pursuant to 28 U.S.C. § 1409.

3. Dennis Faulkner, Trustee, the Plaintiff herein, has the legal capacity to sue and recover on the claims presented in the Plaintiff's First Amended Complaint.

Breach of Contract

4. EOP breached the Lease by initiating a draw request on the Letter of Credit on October 22, 2001. Alternatively, EOP breached the Lease by seeking more than the amount of EOP's claim.

5. The Letter of Credit was expressly a part of the Security Deposit under the Lease.

6. The deemed rejection of the Lease as of October 1, 2001, which was approved by the Court on November 8, 2001, did not retroactively entitle EOP to make a draw request on the Letter of Credit. Alternatively, if EOP was retroactively entitled, it could not claim more than the law allows, and must return the excess.

7. Section 502(b)(6) of the Bankruptcy Code mandates that a lessor's claim for damages for termination of an unexpired lease is subject to a statutory cap. That cap is "designed to compensate the landlord for his loss while not permitting a claim so large as to prevent other general unsecured creditors from recovering a dividend from the estate." *In re Handy Andy Home Improvement Ctrs., Inc.*, 222 B.R. 571, 574 (Bankr. N.D. Ill. 1998) citing (*Collier on Bankruptcy* § 502.03 at 7a (15th ed. 1998)). Section 502(b)(6) provides that the claim of a lessor for damages resulting from the termination of a lease of real property is limited to the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the

remaining term of such lease plus any unpaid rent due under such lease without acceleration.

8. In *Handy Andy Home Improvement*, the court noted

> [s]ection 502(b)(6) is ambiguous, as it contains no reference to the treatment of security deposits. Where, as here, the statute does not address the set-off issue, so that the statutory language contains an ambiguity on its face, legislative history may be considered. *See generally United States v. Kinsley*, 518 F.2d 665, 669 (8th Cir. 1975). The House and Senate Reports state that the landlord "will not be permitted to offset his actual damages against his security deposit and then claim for the balance under [Section 502(6)(b)] . Rather, his security deposit will be applied in satisfaction of the claim that is allowed under this paragraph." H.R. REP. No. 595 (1977) and S. REP. No. 989 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5787. It is "well-settled that a security deposit held by a lessor on a rejected lease must be applied against the maximum claim for lease termination damages allowed to the lessor under § 502(b)(6)." *In re Atlantic Container Corp.*, 133 B.R. 980, 988 (Bankr. N.D. Ill. 1991).

In re Handy Andy Home Improvement Ctrs., Inc., 222 B.R. at 574 (footnote omitted). Thus, a security deposit held by the landlord with respect to a lease rejected by the tenant must be applied against the claim as capped pursuant to § 502(b)(6). *Cf.* Geoffrey Berman, *Landlords Use of Letters of Credit to Bypass the Claim Cap of § 502(b)(6)*, ABI J., Dec./Jan. 2002 at 16.

9. The legislative history of § 502(b)(6) states that the landlord "will not be permitted to offset his actual damages against his security deposit and then claim for the balance under [§ 502(b)(6)]. Rather, his security deposit will be applied in satisfaction of the claim that is allowed under [§ 502(b)(6)]." H.R. Rep. No. 95-595, at 353-55 (1977).

10. As long as the landlord applied the security deposit subsequent to the date of the tenant's bankruptcy filing, § 502(b)(6) will require the security deposit be subtracted from the landlord's § 502(b)(6) claim. *See In re PPI Enterprises (U.S.), Inc.*, 228 B.R. 339, 350 (Bankr. D. Del. 1998). In applying the legislative history of the statute and attempting to achieve Congress' goal, at least one court has ruled that a security deposit must be applied to payment of the landlord's

claim, as capped by § 502(6)(6), and also when the security deposit is in the form of a letter of credit. *Id.*

11. The parties stipulated that Stonebridge owed EOP rent and other charges, including tenant improvement overages, electric bills and invoices from work orders performed by EOP, totaling $71,895.61 on the petition date. Such "rent and other charges," constitute unpaid rent for purposes of § 502(b)(6)(B) pursuant to the terms of the lease.

12. Therefore, pursuant to 11 U.S.C. § 502(b)(6) of the Bankruptcy Code, EOP's damages arising from Stonebridge's rejection of the Lease are limited to $1,353,031.02 (one year's rent under the Lease plus unpaid rent as of the date of Debtor's bankruptcy).

13. Stonebridge was damaged by EOP's actions in the amount of $2,267.23.

Negligent Misrepresentation

14. For a negligent misrepresentation claim, a plaintiff must prove (1) a representation was made by the defendant in the course of defendant's business or in a transaction in which defendant had an interest; (2) in the course of the representation, the defendant supplied false information for the guidance of others; (3) defendant did not exercise reasonable care or competence in obtaining or communicating the information; (4) plaintiff justifiably relied on the representation; and (5) defendant's misrepresentation proximately caused plaintiff's pecuniary injury. *See generally, McCamish, Martin, Brown & Loeffler v. FE Appling Interests*, 991 S.W. 2d 787,791 (Tex. 1999).

15. Rejection of an unexpired lease can only be accomplished by an order of the bankruptcy court. *See* 11 U.S.C. § 365(a); *Arizona Appetito's Stores, Inc. v. Paradise Vill. Inv. Co.*, 893 F.2d 216, 220 (9th Cir. 1990). Matt Koritz testified at trial that the funds "due and owing" to Defendant as a result of Stonebridge's failure to comply with one or more terms of the Lease

represented Defendant's damages under the Lease. *See* Trial Test. of Matt Koritz, Tr. at 28, lines 17-25. However, neither on October 22, or October 24, 2001, the Court had not entered an order formally rejecting the Lease and Stonebridge had not been provided notice of any default under the Lease. At the time of the draw request, the lease had not been rejected, and Defendant had not sustained damages in the amount claimed. Therefore, Defendant's representation that $1,430,065.74 was due and owing Defendant was false. Alternatively, if the retroactive rejection somehow makes a claim due and owing, such claim was capped under § 502(b)(6).

16. Since Defendant based its damages and the representations contained in the draw request on Stonebridge's proposed rejection of the Lease, and ignored the limit on its damages, and since, at the time of the draw request, the Lease had not even been rejected, Defendant did not exercise reasonable care in determining the truth or falsity of the representation that the amount of the draw request represented funds "due and owing" to Defendant.

17. The Bank justifiably relied on the representation of Defendant when it honored the draw request. Reta Pennington, of the Bank, testified by deposition that the Bank was obligated to honor the draw request without any further inquiry if it included, among other things, language that the funds requested were "due and owing" to Defendant. *See* Deposition of Reta Pennington at 25, lines 18-20. Consequently, the Bank of Oklahoma's reliance on Defendant's misrepresentation was justifiable.

18. EOP's draw request on the Letter of Credit constituted a negligent misrepresentation to the Bank.

The Bank of Oklahoma's Pecuniary Injury

19. As a result of Defendant's misrepresentation, the Bank was damaged in the amount

of $180,065.74. This amount represents the difference between the amount paid to Defendant under the Letter of Credit and the amount of the certificate of deposit the Bank cashed in satisfaction of Stonebridge's Note to Bank. Pursuant to a Compromise and Settlement Agreement approved by this Court, the Bank assigned all its claims and causes of action against Defendant to Plaintiff. Accordingly, Plaintiff is entitled to recover $180,065.74 from Defendant as a result of Defendant's negligent misrepresentation to the Bank.

Attorneys' Fees

20. Plaintiff is entitled to recover reasonable attorneys' fees, which will be determined after notice and a hearing.

21. EOP is not entitled to recover attorneys' fees.

22. Any conclusion of law may also be deemed a finding of fact.

Signed: 2-27-03

The Honorable Harlin D. Hale
United States Bankruptcy Judge